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BEFORE THE
SUBCOMMITTEE ON COMMERCE, TRADE, AND CONSUMER PROTECTION
COMMITTEE ON ENERGY AND COMMERCE
UNITED STATES HOUSE OF REPRESENTATIVES
ON
"DIGITAL CONTENT AND ENABLING TECHNOLOGY: SATISFYING THE 21ST CENTURY CONSUMER"

May 3, 2006

Chairman Stearns, Ranking Member Schakowsky, and Members of the Subcommittee, thank you very much for requesting our views on the issue of digital audio content and meeting consumer demand in the marketplace. My name is Michael Ostroff and I am General Counsel and Executive Vice President, Business and Legal Affairs, for the Universal Music Group. Music has been at the forefront of the electronic marketplace and we at Universal have worked hard over the past several years to provide consumers with the most choices and the best digital music experience possible.

We are driven in the marketplace by consumers, and consumers are demanding quality, convenience and choice. Today, consumers have more choices in how they obtain their music than ever before: online downloads such as iTunes; subscription services such as Napster and Rhapsody, including portability features such as Napster to Go, and special discounted rates for subscription services at colleges; ringtones; ringbacks; mobile downloads; mobile videos; online videos on demand; kiosks in retail stores; legitimate peer-to-peer services; interactive web radio; and instant post-concert recorded CDs are just some of the new formats in which we are making music available. These are in addition to new physical formats such as DVD-Audio, Super Audio CD, and DualDiscs.

Considering that all of the products and services listed above have appeared in just the past few years – almost a blink of the eye in the long history of music distribution – you can only imagine what is yet to come in the near future.

Universal is excited about licensing and selling our music in these and other new digital formats to bring more music to more fans from both our vast catalog as well as new artists. And we are flexible in the way we craft digital agreements, so that consumers can use the music they purchase conveniently and in ways that meet their reasonable needs, while at the same time protecting the content against illegal redistribution and other forms of piracy.

We believe that marketplace negotiations have worked best, allowing us to set appropriate rates and ensure reasonable content protection. Such negotiations have worked far better than compulsory licenses, such as those granted to satellite, cable, and Internet listening services. Our legal obligation to make our music available due to this compulsory license leads to situations like one we are facing right now – in which XM satellite radio is offering its customers the ability to download music and create a digital music library on its portable devices, in much the same way that iTunes offers permanent downloads. Of course, the big difference is that in the case of iTunes, Apple compensates artists, creators and copyright owners through a distribution fee.

Let's be clear. Congress gave the satellite services a compulsory license to perform our music, so that their subscribers could listen to it. Our company and others in the industry helped the satellite services get started by agreeing to below market payments for our property. We worked with them to help them develop interesting channels featuring interaction with our artists. Now XM wants to stretch and reinterpret the government imposed license into a service that enables their subscribers to make permanent copies of our music.

Universal Music does not object to XM offering its subscribers a distribution service in addition to a broadcast service, so long as XM agrees to pay us for the distributions. Rather than working to reach a fair accommodation through marketplace negotiations, however, XM claims that the compulsory performance license it enjoys enables it to distribute our content as though it's just another aspect of performing our music, and that its payment for performances covers what are in fact distributions. XM also claims that, instead of paying an appropriate distribution fee, its manufacturing partners are merely required to pay royalties under the Audio Home Recording Act, a payment system that was intended only to cover serial recording on Digital Audio Tapes and was never intended to replace the licenses required for distributions of music.

Allowing XM to make distributions while paying only performance fees is unfair to the legitimate music distribution services like iTunes, Napster, Rhapsody and Yahoo!, that are just starting to gain traction in the face of competition from illegitimate, unauthorized services that have been giving away our music for free. And it is unfair to the music companies and artists who deserve compensation for the blood, sweat, tears and capital they invest in creating new and innovative sounds. The growth of digital distribution in its many forms – via cellphones, internet, cable and now via broadcast signals -- depends upon a legitimate marketplace. A legitimate marketplace, in turn, depends upon the ability to protect content effectively.

The emerging digital formats are made possible because content protection is able to set levels of "ownership" of a copy of our music at different price points. For streaming music, consumers pay at one price point; for permanent downloads, consumers expect to pay at a higher price point. Just like a consumer has a different expectation of price when renting a musical instrument versus buying it. Without the ability to define the parameters of use, without the ability to protect the content, distributors could only offer consumers music on a one-price-fits-all basis; and, in order to cover all platforms

and services, that price would necessarily be higher. That, of course, is not good for consumers. In short, content protection presents more opportunities for content creators and providers, which ultimately leads to more opportunities – and choice – for consumers.

In last year's unanimous *Grokster* decision, the United States Supreme Court gave the legitimate digital marketplace a boost. By holding liable those services that facilitate piracy, the Court opened the door for the legitimate digital marketplace to succeed and emphasized the importance of protecting copyrighted works. Weakening copyright and allowing for the circumvention of content protection is antithetical to the Court's holding; and, by decreasing the market opportunities for both media creators and distributors, the circumventing or "hacking" of content protection ultimately harms consumers.

Unfortunately, a bill has been introduced and referred to this Subcommittee, H.R. 1201, that would undermine the legitimate marketplace by granting a "hacking" right to consumers. It would allow the removal of copy protection contained on a digital product, as long as it is done for "fair use" purposes. This legislation distorts the meaning of fair use and would lead to the exact escalation of piracy the *Grokster* case sought to prevent. Fair use has never meant "free access." If you want to copy a portion of a chapter of a book to quote in a book report, you cannot steal the book in order to do so. Yet, that is exactly what H.R. 1201 would allow. It is the equivalent of allowing a consumer to buy a "black box" to get HBO for free, as long as the consumer is only using it to watch programming for "fair use purposes." And, of course, once the content protection is removed, that protection is compromised for *all* purposes. Given that licensing practices in the marketplace already allow for personal uses that meet consumer expectations, this bill is unnecessary and dangerous.

H.R. 1201 would undo much of what this Committee and the Congress accomplished in 1998 when it passed the "Digital Millennium Copyright Act." Since passage of the DMCA, the digital marketplace for content has exploded. Weakening it would stymie future growth.

In fact, the Congress rejected in 1998 the language proposed in section 5 of H.R. 1201. Instead, under the leadership of the Commerce Committee, Congress created a procedure to ensure that adequate public access to copyrighted materials is maintained: the Librarian of Congress, working with the Commerce Department, investigates, every three years, whether public access to copyrighted materials is being harmed or threatened. In both 2000 and 2003, the Librarian considered broad exceptions similar to H.R. 1201, and rejected them, because proponents could not demonstrate harm.

Another proceeding is in process this year. There is no evidence the Congress made a mistake in 1998. Just the opposite: the Congress got it right, and there is no basis for undoing that decision now.

H.R. 1201 would also undermine efforts to fight piracy and promote respect for copyrights worldwide. Because U.S. copyrighted works dominate world markets, the U.S. Congress and Administrations – Republican and Democrat – have all worked hard

to upgrade copyright law and enforcement internationally. Because America has such a huge stake in intellectual property protection, we set the standard that we hope the world will follow. In recent years, this effort has paid special attention to protecting encryption and similar technologies against hacking. H.R. 1201 would pull the rug out from under these efforts, and expose U.S. works to greater risks of piracy in markets around the globe.

We ask that this Subcommittee reject H.R. 1201, and allow the marketplace to continue to meet consumer expectations. The many different options consumers have today in which to get their music is a function of that legitimate free marketplace. This proves that one thing is certain – if music distribution is left to the free market, we will find a way to license these and many more uses of our music with functionality consumers can only imagine today. Universal has embraced and made deals for numerous different distribution models, and we look forward to welcoming many more in the future. We are extremely eager for consumers to have increasing numbers of options for where they get their music and how they experience it. The better the experience for consumers, the better it is for us as well.

There are instances, however, where we do not have rights, in which the free marketplace is not allowed to work, necessitating changes in the law to maintain a legitimate marketplace. This is perhaps most evident with over-the-air radio. The next generation of new HD Radio devices would allow listeners to record, sort, and permanently store individual songs in a digital jukebox, replicating a sale made from a digital download service such as iTunes. But we have no performance right for over-the-air radio, which means that we have no leverage when seeking to negotiate appropriate use of our music.

Fortunately, we are already in productive discussions with the broadcast industry to ensure that the functionality of these new HD Radio devices does not substitute for sales in the marketplace. In part because of our longstanding relationship with broadcasters, and additionally at the urging of Senators Stevens and Inouye during a January hearing on Broadcast and Audio Flag before the Senate Committee on Commerce, Science and Transportation, representatives of the music and broadcast industries agreed to meet to work out the issues. Since then, there have been several meetings, including a very productive one in New York between senior executives of both industries, resulting in the formation of two negotiating groups, an Audio Flag Task Force and a Technical Implementation Working group. We remain optimistic about these talks, are committed to a swift rollout of HD radio, and continue to believe that the best solution is one that comes from free marketplace negotiations.

But it is important to remember that there remains a marketplace failure due to our lack of an over-the-air performance right – our bargaining power is limited by the fact that we cannot simply say, "no, you may not use our music." Therefore, while we are encouraged that the broadcasters will continue to negotiate in good faith, we appreciate the introduction of legislation such as H.R. 4861, The Audio Broadcast Flag Licensing Act. This bill, introduced by Representatives Ferguson, Towns, Bono, Gordon

and Blackburn, addresses this marketplace failure by granting the FCC jurisdiction to promulgate rules regarding content protection for digital over-the-air radio. The bill requires digital radio services that use the government spectrum to implement certain content protection technology. H.R. 4861 strikes the right balance between creating new radio services that bring more choices to consumers, and protecting the property rights of creators. The bill also prevents unfair competition between radio services and download services, by appropriately providing for private market negotiations of an "audio broadcast flag" that will differentiate between radio broadcasts and download services, and require a market license only for download services.

The bill assures that no one device or technology manufacturer has an advantage over another and will maximize the range of broadcast receiving devices made available to the public. Further, it makes clear that the adoption and implementation of an audio broadcast flag will in no way delay the final operational rules for digital radio and assures that legacy devices are not affected. By using broadcast flag technology, devices already on the market prior to the enactment of legislation will not be made obsolete, but will remain fully functional.

At the same time, we agree with the leadership of the Senate Commerce Committee that it is preferable to find a marketplace solution, and appreciate that they have asked the parties to work toward such a solution and report to the Committee periodically. As Senator Stevens said, "the creative content side and the distribution side of the music industry should seek mutual ground that supports business models for both."

And we greatly appreciate NAB President David Rehr's acknowledgement of his industry's "strong interest in collaborating to find a workable solution to content protection issues associated with terrestrial digital radio broadcasting," and his agreeing in a joint report to the Committee that the scope of the negotiations on flag implementation would include usage rules preventing the disaggregation or "cherry-picking" of songs from surrounding content transmitted over HD radio, and assurance of an expeditious rollout of HD radio nationwide. Following the positive initial meetings between our industries, we think we are on the right track.

The future of the digital marketplace is a great one for consumers in the 21st century. Wouldn't it be great if you could push a button and buy a song when you hear it on the radio that is automatically charged to your credit card? Or to push a button on your iPod that automatically purchases an individual track? Or to play any song on demand on your portable player any time you want for a monthly fee? All of this is possible in the free market in a manner that maintains the incentive to create and invest in music. Robust content protection, and preventing against the hacking of that protection, will assure that possibility for consumers, and provide a return on investment for creators, broadcasters, device manufacturers, and all other parties that bring new and exciting entertainment to market.

Thank you for focusing on this important issue.